

201059

HOGAN & HARTSON
L.L.P.

ERIC VON SALZEN
PARTNER
(202) 637-5718
EAVONSALZEN@HHLAW.COM

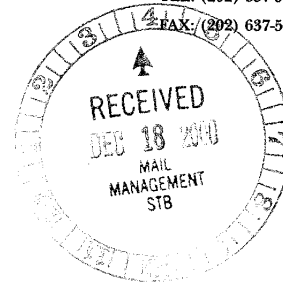
December 18, 2000

ENTERED
Office of the Secretary
DEC 18 2000
Part of
Public Record

COLUMBIA SQUARE
555 THIRTEENTH STREET, NW
WASHINGTON, DC 20004-1109
TEL: (202) 637-5600
FAX: (202) 637-5910

BY HAND DELIVERY

The Honorable Vernon A. Williams
Secretary, Surface Transportation Board
Case Control Branch
1925 K Street, N.W.
Washington, DC 20423-0001



Re: STB Ex Parte No. 582 (Sub-No. 1), Major Rail
Consolidation Procedures

Dear Secretary Williams:

Enclosed for filing in the above-referenced docket are an original and twenty-five copies of the Reply Comments of the Committee To Improve American Coal Transportation. Also enclosed is a 3.5-inch diskette, formatted for WordPerfect 5.x, containing the pleading.

Thank you for your assistance.

Very truly yours,

A handwritten signature in dark ink, appearing to read 'Eric Von Salzen'.

Eric Von Salzen
Attorney for the Committee To
Improve American Coal Transportation

ENTERED
Office of the Secretary
DEC 18 2000
Part of
Public Record

MIT/mpr

Enclosures

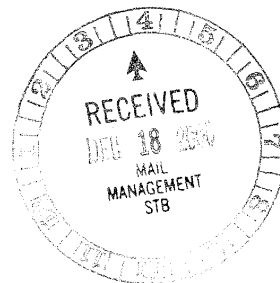
cc: All Parties of Record To Be Served

201059

BEFORE THE
SURFACE TRANSPORTATION BOARD

STB Ex Parte No. 582 (Sub-No. 1)

MAJOR RAIL CONSOLIDATION PROCEDURES



ENTERED
Office of the Secretary

DEC 18 2000

Part of
Public Record

REPLY
COMMENTS OF
THE COMMITTEE TO IMPROVE
AMERICAN COAL TRANSPORTATION

ENTERED
Office of the Secretary

DEC 18 2000

Part of
Public Record

George W. Mayo, Jr.
Eric Von Salzen
Marta I. Tanenhaus
HOGAN & HARTSON L.L.P.
555 Thirteenth Street, N.W.
Washington, D.C. 20004-1109
(202) 637-5600

Attorneys for the Committee To Improve
American Coal Transportation

December 18, 2000

TABLE OF CONTENTS

<u>INTRODUCTION AND SUMMARY</u>	5
<u>DISCUSSION</u>	7
<u>A. THERE IS BROAD PUBLIC SUPPORT FOR THE GOALS OF THE BOARD’S PROPOSED RULES, BUT THE RULES CAN BE IMPROVED TO ENHANCE COMPETITION AND SAFEGUARD SERVICE</u>	9
1. Summary	9
2. The Board Should Abandon Its Old Pro-Merger Policy And Make Clear It Will Not Approve An Anticompetitive Merger.....	9
3. The Board’s Merger Policy Should Focus On Intramodal Competition.....	12
4. The Board Should Require That Rail Customers Be Effectively Protected Against Service Disruptions Caused By Mergers.....	13
5. The Board’s Merger Rules Should Incorporate Effective Means To Preserve And Enhance Intramodal Competition.....	15
a. Maintaining Open Gateways, While Desirable, Is Inadequate To Preserve Intramodal Competition.....	15
b. Post-Merger Monitoring, While Desirable, Is Inadequate To Preserve Intramodal Competition.....	17
c. Elimination Of Paper And Steel Barriers, While Desirable, Is Inadequate To Preserve Intramodal Competition.....	19
d. The Board Should Abandon Its “One Lump” Theory, But Preserving Its Current Inadequate “Bottleneck” Rules Will Not Preserve Intramodal Competition.....	20
e. The Board Should Not Permit Acquisition Premiums To Erode The Rate Protections Available For Captive Shippers.....	21
f. A Rail Service Secondary Market Is A Promising Innovation That The Board Should Consider.....	22
g. Effective Intramodal Competition Requires That The Number Of Railroads Serving Markets Be Increased; This Can Best Be Done Through Divestiture; Competitive Access Is A “Second Best” Solution.....	22
6. The Board Should Consider The Cumulative And Crossover Effects Of Mergers, Both Upstream and Downstream.....	24
7. If The Board’s Merger Policy Fails To Halt The Class I Railroad’s Headlong Rush To Duopoly, A Return To Strict Regulation Will Be Inevitable.....	25

<u>B. THE BIG RAILROADS' OPPOSITION TO MERGER REFORM THREATENS TO CREATE A CONTINENTAL DUOPOLY AND A RETURN TO STRICT REGULATION</u>	26
1. Summary	26
2. The Big Railroads' Insistence On A Pro-Merger Policy Is Wrong.	27
3. The Big Railroads' Objections To The Board's Minimal Efforts To Promote Competition Are Unfounded.	30
4. The Board Is Correct That Downstream Effects Of Mergers Should Be Considered.....	34
5. The Big Railroads' Objections To Post-Merger Oversight Are Exaggerated, But Oversight Should Not Be Relied On To Prevent Anticompetitive Mergers From Injuring The Public.	38
6. The Service Assurance Plans That The Big Railroads Say They Support Are Insufficient To Protect Railroad Customers.....	38
7. The Board Should Adopt A Procedural Schedule That Allows Adequate Investigation And Evaluation Of Proposed Mergers.....	40
8. There Should Be No Special Exception From The Merger Rules For KCS At This Time.....	42
<u>CONCLUSION</u>	42

BEFORE THE
SURFACE TRANSPORTATION BOARD

STB Ex Parte No. 582 (Sub-No. 1)

MAJOR RAIL CONSOLIDATION PROCEDURES

**REPLY
COMMENTS OF
THE COMMITTEE TO IMPROVE
AMERICAN COAL TRANSPORTATION**

INTRODUCTION AND SUMMARY

The Comments on the Board's Notice of Proposed Rulemaking disclose broad agreement among railroad customers, smaller railroads, and government agencies that the Board's rail merger rules need to be changed to reflect current realities. These commenters endorse the stated objectives of the Board's Proposed Rules, but they conclude that the changes the Board proposes are insufficient to achieve those objectives. The Comments include numerous thoughtful and constructive suggestions for improving the Rules and making them more effective.

There is also agreement among the big railroads – agreement that any rule change that puts effective limitations on rail mergers is intolerable. They profess shock and dismay that the Board would even consider interfering with what they regard as their divine right to merge. Repeatedly they accuse the Board of threatening their marketplace freedoms with the heavy hand of regulation.

Yet it is the big railroads themselves that are actually creating the risk of stricter regulation. By their actions over the last decade – by their relentless

drive to expand their market power through mergers, by their insistence on exploiting every advantage they could wring out of the current regulatory scheme, by their stubborn resistance to meaningful changes in merger rules – the giant rail systems have left the Board with a stark choice. If the Board follows the course advocated by the big railroads, the final round of rail mergers will begin as soon as the Board's temporary merger moratorium expires only six months from now, and it will end with the North American rail industry dominated by two huge rail systems. In such a world, there can be no effective rail-to-rail competition, and the return to strict regulation of the railroad industry would be inevitable.

If, on the other hand, the Board follows the course advocated by IMPACT 1/ and others, if it adopts meaningful rules to enhance intramodal competition, so that rail-dependent shippers will have the ability to choose among rail carriers, then there will be a chance that the promise of the Staggers Act, “a sound rail transportation system with effective competition among rail carriers,” 2/ will be fulfilled.

1/ IMPACT, the Committee to Improve American Coal Transportation, is an ad hoc group of energy companies that operate coal-fired electricity generation assets. The members of IMPACT are listed in Appendix A to IMPACT's November 17th Comments.

2/ Santa Fe Southern Pacific Corp. – Control – Southern Pacific Transportation Co., 2 I.C.C. 2d 709, 722 (1986) (“SF-SP”) (quoting Norfolk Southern Corp. – Control – Norfolk & Western Ry., 366 I.C.C. 171, 190 (1982).

DISCUSSION

In considering new rules governing mergers between or among Class I railroads, three questions are paramount. First, what is the current state and structure of the rail industry? Second, in what direction is the industry headed? Third, is that the right direction?

The answers to the first two questions are obvious. 1) The North American Class I railroad industry includes of six huge rail systems, two in the U.S. west, two in the U.S. east, and two in Canada (both with substantial extensions into the U.S.). 2) Before the Board imposed a 15-month moratorium, the industry was on the brink of a merger that would have precipitated a series of responsive mergers, ending in a continent-wide duopoly; whether the industry goes over that brink after the moratorium expires in June depends on the outcome of these proceedings.

On the third question, the vast majority of commenters answer with a resounding No! If the Class I railroad industry collapses into a duopoly, the last hope for preserving and restoring adequate competition in that industry will have failed, and the regulatory freedoms granted by the Staggers Act will be at an end.

In their comments, the big railroads 3/ have generally ducked all three questions. They treat their industry as though it were like industries with

3/ In these Reply Comments, IMPACT uses the phrase "big railroads" as a short-hand to refer to the six largest Class I railroads and their affiliates. This convention is intended to exclude Kansas City Southern, which is not only the smallest of the independent Class I

[Footnote continued]

hundreds or thousands of market participants, in which each merger can be evaluated on a case-by-case basis, without worrying much about its effect on the overall structure of the industry. For example, a consultant for one of the big railroads argues that the Board's merger policy should be similar to the policy followed by FERC for the electric utility industry (BNSF Comments (Pierce Statement at 7-11)), but there are hundreds of companies in the electric industry, compared to the six giant Class I railroads. ^{4/} Given the current structure of the industry, treating Class I rail mergers as "business as usual", as the big railroads urge, makes no sense. ^{5/}

In Part A, below, IMPACT discusses comments offered by a wide variety of rail customers, smaller railroads, and government agencies, who support the Board's goals, but who believe that the Proposed Rules are inadequate to achieve them. In Part B, IMPACT discusses the comments offered by the big railroads, which (with a few variations on the theme) advocate no meaningful changes in the Board's merger rules.

[Footnote continued]

railroads, but which also takes positions on several issues that are different from those advanced by the big railroads.

^{4/} BNSF's consultant says that in four years, FERC considered 42 mergers (BNSF Comments (Pierce Statement at 9)), whereas two to four mergers of Class I railroads is all it will take to reach a North American duopoly.

^{5/} As discussed in Part B of these Reply Comments, Union Pacific is an exception to the extent that it actually recognizes that the Class I railroads are headed for duopoly and thinks it legitimate for the Board to ask whether that is a good thing.

A. THERE IS BROAD PUBLIC SUPPORT FOR THE GOALS OF THE BOARD'S PROPOSED RULES, BUT THE RULES CAN BE IMPROVED TO ENHANCE COMPETITION AND SAFEGUARD SERVICE

1. Summary

Like IMPACT, the vast majority of commenters support the stated goals of the Board's Proposed Rules: To preserve and enhance competition, and to protect rail customers from the service failures that have been caused by recent mergers. However, also like IMPACT, most of the commenters believe that the Proposed Rules are not strong enough, nor specific enough, to achieve the Board's goals. They identify several measures that the Board should adopt to make its merger policies more effective.

IMPACT supports most of the improvements that these commenters propose be made to the Board's merger rules. However, we stress that to be effective, the Board's rules need to be focused on the objective of increasing the number of independent rail carriers serving any rail dependent market to three, if possible. This can best be accomplished by making greater use of the standard antitrust remedy of divestiture.

2. The Board Should Abandon Its Old Pro-Merger Policy And Make Clear It Will Not Approve An Anticompetitive Merger.

Most commenters believe that the Board needs to abandon the pro-merger policy it has followed since the enactment of the Staggers Act. The National Industrial Transportation League, for example, considers such a shift in policy necessary to cure the loss of rail competition caused by past consolidations, and it sees the Proposed Rules as moving the Board toward a position of neutrality. See

NITL Comments at 5. Williams Energy Services endorses a proposal earlier made by the U.S. Department of Agriculture that the new rules should incorporate a rebuttable presumption against further major rail mergers. See Williams Comments at 3, 14, 19.

IMPACT agrees that the time for a pro-merger policy has long passed. The mergers of the last decade have eroded rail to rail competition and created a highly concentrated Class I railroad industry that fails to give its customers adequate rail transportation options. See IMPACT's opening Comments at 5-6. Whether the new policy should be called "neutral" or "anti-merger" 6/ is not as important as establishing the principle that the Board will not approve new Class I rail mergers unless they preserve and enhance intramodal competition.

The Proposed Rules are not as clear on this point as they need to be; they appear to leave open the possibility that the Board might approve an anticompetitive merger. PPL Generation LLC points out that "proposed 49 C.F.R. § 1180.1 states that 'the Board does not favor consolidations that reduce railroad and other transportation alternatives,' but this statement is immediately qualified by the words 'unless there are substantial and demonstrable public benefits . . . that cannot otherwise be achieved.' " This implies that a merger that reduced

6/ The big railroads condemn the Proposed Rules as incorporating presumptions against mergers, which they claim is improper. See, e.g., BNSF Comments (Pierce Statement at 15); NS Comments at 23. In IMPACT's view, what the Board has done is to recognize that in a Class I railroad industry with only six major participants, any proposed Class I merger will raise a threat of reducing intramodal competition. It is not an improper "presumption" to seek ways to deal with this reality.

competition could be approved if the applicants could show other ways the transaction would benefit the public. See PPL Comments at 18.

As NITL points out, approving an anticompetitive merger because of other supposed public benefits “would be flatly inconsistent with sound public policy, and inconsistent even with the Board’s past practice. Specifically, the Board should make clear that, where a reduction in competition can be specifically proved, then such specifically-identified reductions in competition should be cured as part of the Board’s requirements for approval of the proposed merger.” See NITL Comments at 12. 7/

IMPACT agrees that the Board’s merger rules should make clear that any merger that is found to be anticompetitive will be rejected. Promises of “public benefits” by merging parties are uncertain and all too often have proven to be pie in the sky, while the result of an anticompetitive merger can be counted on with certainty: duopoly or monopoly in the rail industry and a return to strict regulation. As discussed in Part B, below, the big railroads themselves concede that promised “public benefits” are nothing but estimates, that the Board cannot enforce against merger applicants.

Furthermore, it is important that the Board make clear in its merger rules that it will not take the initiative to save an anticompetitive merger proposal by adding additional conditions. As IMPACT said in its opening Comments (at 22):

7/ See also National Mining Association Comments at 3.

“If applicants propose a merger without sufficient conditions to eliminate competitive injury, the Board should deny the merger.” ^{8/}

This requirement would not impose an insuperable burden on merger applicants, if the Board makes clear that adequate intramodal competition requires three independent rail carriers in rail dependent markets. Merger applicants will know that they must structure their proposals and their conditions to preserve adequate intramodal competition where it exists and to increase it where it is currently inadequate. If they do so, and satisfy the other criteria of the merger policy, their mergers should be approved; otherwise they should be denied. See IMPACT’s opening Comments at 5-16. ^{9/}

3. The Board’s Merger Policy Should Focus On Intramodal Competition.

Although commenters generally endorse the Board’s stated objective to preserve and enhance competition and prevent service disruptions, most are concerned that the Proposed Rules are often too vague and lacking in specifics to accomplish those goals. A fundamental problem, noted by a number of parties, is the Board’s failure to stress the importance of preserving and enhancing intramodal

^{8/} See also National Mining Association Comments at 2 (“No railroad merger should be approved if it would diminish effective transportation competition for moving the same commodity from the same origination to the same termination.”); Williams Comments at 3 (The Board should reject any merger application that fails to demonstrate that the merger benefits the public, not just the merging parties.).

^{9/} Edison Electric Institute agrees that three rail options are required in order for competition to exist in a specific market. See EEI Comments at 10. See also KCS Comments at 12, 30 (Two (or even three or four) rail competitors may be insufficient in certain instances.).

competition in the context of a rail consolidation. KCS, for example, stresses that the new rules “should leave no doubt that the preservation of rail-to-rail competition is the single most important factor examined by the Board in weighing the merits of a proposed rail consolidation.” See KCS Comments at 8. The U.S. Department of Transportation adds that enhancement of rail to rail competition will “help ensure the national rail system’s sustainability.” See USDOT Comments at 3. ^{10/}

IMPACT agrees that the Board should clarify the Proposed Rules to assure that the preservation and enhancement of rail to rail competition is clearly required in any new merger. Furthermore, as IMPACT demonstrated in its opening Comments and in its earlier May 16, 2000 Comments, three independent rail carriers are needed to provide adequate intramodal competition in major markets. IMPACT urges that Board merger policy be directed toward this objective. See IMPACT’s opening Comments at 4, 5-16.

4. The Board Should Require That Rail Customers Be Effectively Protected Against Service Disruptions Caused By Mergers.

IMPACT and most other commenters agree with the Board’s proposals for more effective assurances by merger applicants that rail services will not deteriorate after a merger, but they are concerned that the proposed rules fail to

^{10/} See also, e.g., KCS Comments at 10, 27; PPG Industries, Inc. Comments at 2; National Mining Association Comments at 2; NITL Comments at 4, 11; Joint Comments of Certain Coal Shippers at 26-27; Alliance for Rail Competition (“ARC”) Comments at 3; State of New York Comments at 6-9.

offer clear procedures and standards to accomplish this goal. In view of the historic evidence of post-merger service breakdowns, a “service assurance plan” is not enough. ^{11/} If the plans go awry, there need to be provisions for the payment of damages to the harmed customer and penalties for the rail carrier. ^{12/}

Commenters offer a variety of solutions to this problem. NITL urges that the Board require that service assurance plans include specific provisions for compensation to injured customers, including expedited arbitration, and for alternative rail service. See NITL Comments at 22-23. Certain Coal Shippers urge that compensation be awarded for “any measurable reduction in rail service”, that customers be allowed to recover consequential damages for service failures, and that there be a presumption that alternative service will not interfere with the merged carriers’ operations. See Certain Coal Shippers Comments at 18. PPL Generation urges that merger applicants state in advance whether they are committed to solving service problems without raising rates. See PPL Generation Comments at 14-15. Other commenters offer equally useful suggestions. ^{13/}

^{11/} See IMPACT’s opening Comments at 16-18. See also NITL Comments at 20-21; National Mining Association Comments at 2; Williams Comments at 25-28. Cf. KCS Comments at 33-34 (“[T]he Board should clarify the role that the service assurance plan will play” and hold the merging parties to the overall level of service envisioned.).

^{12/} See, e.g., Joint Comments of Certain Coal Shippers at 16-18; NITL Comments at 22-24; USDOT Comments at 9; National Mining Association Comments at 2; Subscribing Coal Shippers Comments at 20; EEI Comments at 9; Williams Comments at 25-29; American Short Line and Regional Railroad Association (“ASLRRA”) Comments at 3.

^{13/} See, e.g., USDOT Comments at 7-12; National Mining Association Comments at 2; EEI Comments at 9; Williams Comments at 7; PPG Comments at 2; Subscribing Coal Shippers Comments at 20-23.

IMPACT endorses all of these proposals and urges the Board to incorporate them into its merger rules. However, the most effective way to achieve the goals of all these commenters is to require that merger applicants show the Board they have entered into agreements with their customers to provide service assurances that the customers consider adequate. To make this happen, service assurances offered by a merging party that are in good faith rejected by customers should be grounds for Board rejection of that merger. See IMPACT's opening Comments at 16-18.

5. The Board's Merger Rules Should Incorporate Effective Means To Preserve And Enhance Intramodal Competition.

Although the stated goal of the Board's Proposed Rules is to preserve and increase railroad competition, the Rules are too vague and lacking in specificity to accomplish this goal.

a. Maintaining Open Gateways, While Desirable, Is Inadequate To Preserve Intramodal Competition.

The Board's proposed rules require that applicants must show how they will preserve the use of major gateways. Most commenters agree with this idea, but they point out that the rules are too limited in scope. The proposed rule should not be limited to "major" gateways, and should be clarified to preclude the economic closure of gateways. 14/

14/ See, e.g., USDOT Comments at 5; EEI Comments at 9; ARC Comments at 2; NITL Comments at 20; Enron Corporation Comments at 1; ASLRRA Comments at 3; North Dakota Public Service Commission, North Dakota Grain Dealers Association, North Dakota Wheat Commission, and North Dakota Barley Council ("North Dakota Parties") Comments

[Footnote continued]

IMPACT endorses these comments. However, a commitment to keep existing gateways open will do little to preserve competition and can do nothing to enhance it. A gateway is unlikely to remain open for long if the railroad involved perceives that it will benefit from closing it. As UP points out, “[v]ague assurances that gateways will stay open are not sufficient because there are too many ways to close them commercially.” See UP Comments at 32. The broader the open gateway condition – the greater the number gateways covered and the more the condition seeks to preclude economic as well as de jure closure – the more difficult it will be to enforce. In fact, merger applicants have often offered a commitment to maintain open gateways, in hopes of forestalling the imposition of more effective conditions.

Gateways will remain open if the railroads involved see it as in their self-interest to keep them open. And this will happen only if there is adequate

[Footnote continued]

at 3. Even BNSF supports the Board’s suggestion that merging railroads be required to keep major gateways open. BNSF Comments at 5.

Other commenters provide suggestions for modification of the proposed rules. See, e.g., PPG Comments at 2 (Proposed rules should include specific safeguards to preserve access to all gateways); NITL Comments at 18-20 (Board should clarify what it means by “major existing gateway” and interpret it broadly; the proposed regulations should prohibit the closure of any interchange unless the merging carrier can show it is not “necessary to preserve the competitive routing options of any shipper or that maintenance of the existing interchange would be patently inefficient.”); American Chemistry Council and the American Plastics Council Comments (Kammerer Statement at 6) (“One way to ensure that gateways will be kept open following mergers is to require the origin carrier to provide rates to the closer interchange points that are in proportion (by distance) to the rate that is offered to the longer point.”); Ameren Comments at 3 (“Gateway protection should apply, not just to major gateways, but to all gateways through which traffic has been interchanged to a competitor.”).

intramodal competition in the relevant markets. Take an obvious example. Two big railroads now serve the Powder River Basin coal fields, BNSF and UP. It is possible under today's circumstances for a third railroad to consider entering into that market (as, for example, DM&E has proposed) and to find several potential "friendly" connections to the east. However, if (say) BNSF were to merge with one of the big eastern or Canadian railroads, and if UP then merged with another big eastern or Canadian railroad, some or all potential friendly connections would be lost. It is unlikely that any open gateway condition could possibly overcome the commitment of the two merged megasystems to dominate that market.

b. Post-Merger Monitoring, While Desirable, Is Inadequate To Preserve Intramodal Competition.

Like gateway conditions, oversight conditions for post-merger monitoring of competitive and service issues may provide some limited benefits, ^{15/} but such conditions are unlikely to be very effective in preserving, much less enhancing, intramodal competition. As ARC explains, for example, "[n]o amount of regulatory monitoring will correct the harms caused by a merger that does not live

^{15/} See National Mining Association Comments at 2, 4 (Proposed rules should include monitoring of carrier's specific commitments to post-merger service and the availability of remedial action for failure to comply.); California Public Utilities Commission Comments at 4-5 (Recommending language requiring merged parties to include detailed accounts of post-merger gains and to sanction carriers that fail to meet promised goals.); IMC Global Inc. Comments at 4 (Meaningful and enforceable penalties should be imposed against merged carriers failing to achieve post-merger service promises.); NITL Comments at 25-26 (NITL believes that the Board focuses too much on generalized operational data that is of limited use to shippers and that the new rules should include the more useable data of "transit and/or cycle times for traffic categories over major corridors for the years preceding and following the application and implementation of the transaction.").

up to expectations. Certainly, once the damage has been done, it is difficult to undo.” See ARC Comments at 2.

In IMPACT’s May 16, 2000 Comments, the attached Statement of Michael A. Nelson cited (at pp. 58-59) a number of examples in which oversight failed to ameliorate negative effects of mergers. For example, Central Corridor source competition for coal was lost as a result of the UP-SP merger, but oversight has done nothing to redress that loss. For a recent example of the ineffectiveness of post-merger monitoring to preserve competition, see CSX Corp. – Control and Operating Leases/Agreements – Conrail, Inc., STB Finance Docket No. 33388, (Decision served November 30, 2000), where the Board denied Indianapolis Power and Light Company’s request for relief from competitive harm from the Conrail transaction.

In the past, the Board has used oversight conditions as a palliative for merger opponents’ concerns that a merger will have anticompetitive or other bad effects. Such a condition may therefore actually make it easier for the Board to approve questionable mergers.

Nevertheless, IMPACT agrees with other parties that it makes sense for the Board to formalize its oversight practice as the Proposed Rules would do, even though this practice will not contribute significantly to the preservation of competition.

c. Elimination Of Paper And Steel Barriers, While Desirable, Is Inadequate To Preserve Intramodal Competition.

IMPACT supports the many shippers and small railroads advocating the elimination of paper and steel barriers, thereby opening up new markets to Class II and Class III railroads. ASLRRA, representing 418 short lines and regional railroads, urges the Board to adopt merger policies which would grant these carriers interchange and routing freedom. See ASLRRA Comments at 2-3. To this end ASLRRA advocates the removal of contractual barriers affecting small railroads connecting with consolidated carriers that interfere with full interchange rights and competitive routes and rates and that limit their ability to interchange freely with all other railroads in terminal areas. Id. at 3. Many other commenters also agree that the proposed rules should more clearly indicate that merging railroads must give up paper and steel barriers. 16/

However, in most cases, these reforms can enhance intramodal competition only where they permit another major railroad to use a shortline or regional carrier to reach an otherwise captive customer. Unless there are more Class I railroads in major markets, removal of such restrictions on small railroads can have only a minimal effect on competition.

16/ See, e.g., Ameren Services Company Comments at 3; EEI Comments at 8-9; PPG Comments at 2; PPL Comments at 15-18; Subscribing Coal Shippers Comments at 18-19; Certain Coal Shippers Comments at 18-19; State of New York Comments at 15-16. Cf. KCS Comments at 15, 30-31 (Advocating that the Board thoroughly examine in the context of any new rail transaction, the potential harm to essential services that paper and steel barriers could cause.).

d. The Board Should Abandon Its “One Lump” Theory, But Preserving Its Current Inadequate “Bottleneck” Rules Will Not Preserve Intramodal Competition.

As stated in its opening Comments (at 27-28), IMPACT favors the abandonment of the one-lump theory, under which the ICC and Board allowed mergers to extend existing monopolies without requiring conditions to ameliorate their anti-competitive effects. Other commenters agree. For example, NITL calls the one lump theory “terribly flawed in practice”, in that many mergers result in the loss of segment competition that shippers had enjoyed pre-merger. See NITL Comments at 6. NITL endorses proposed Section 1180.1(c)(2), because it believes the rule “impliedly discard[s]” the one lump theory by providing, post-merger, for the “continued opportunity to enter into contracts for one segment of a movement as a means of gaining the right to separately pursue rate relief for the remainder of the movement.” Id. at 8. EEI says that most shippers would agree that “reliance on the ‘one lump’ theory would be mistaken” and EEI encourages the Board to take a greater role in determining whether the evidence supports the theory in future merger situations. See EEI Comments at 10.

While IMPACT agrees that mergers should not be permitted to eliminate any opportunities for rail customers to seek “bottleneck” relief under the Board’s rules, 17/ those rules are so restrictive that extending them to new mergers

17/ See USDOT Comments at 5-7; Subscribing Coal Shippers Comments at 17-18; EEI Comments at 6-8; Certain Coal Shippers Comments at 13-16; Ameren Comments at 2-3. Even BNSF supports the Board’s proposal to impose conditions that would prevent mergers

[Footnote continued]

will do little to preserve or increase competition. See Enron Comments at 1 (The proposed rule preserving the rate for challengeable segments in bottleneck situations will have “minimal significance . . . since it appears to be nothing more than a statement of existing law.”). Only by increasing the number of rail competitors can competition be preserved or enhanced.

e. The Board Should Not Permit Acquisition Premiums To Erode The Rate Protections Available For Captive Shippers.

Past Board practice has exacerbated the anticompetitive effects of rail mergers by allowing the merged carriers to pass along to customers, in the form of rate increases, the acquisition premiums paid by the railroads in their consolidation transactions. This practice has no place in an industry suffering from inadequate intramodal competition, because it nullifies rate protections that are supposed to protect captive shippers. IMPACT supports the proposals to prohibit the financial abuse imposed on shippers by the acquisition premium. 18/

[Footnote continued]

from diluting available “bottleneck” relief through the “contract exception.” BNSF Comments at 5.

18/ See NITL Comments at 26-27 (Requesting the Board revise the proposed rules “to forbid carriers from including any acquisition premium in its calculation of either the jurisdictional threshold [for rate regulation] or in evaluating a carrier’s revenue adequacy.” As a further step against rate hikes unjustified by carrier cost increases, the NITL urged the Board to examine, more carefully that it has done in the past, “the possible effects of the financial burden imposed by a proposed consolidation transaction.”); EEL Comments at 11 (Suggesting that the rules ought to clearly prohibit passing along acquisition premiums to customers, as other agencies require. The result would benefit both shippers and carriers because it would engender smaller premiums in transactions that railroads could more easily absorb. Also, urged the Board to request a voluntary remand of this issue from the Second Circuit in the pending Conrail appeals.); Subscribing Coal Shippers Comments at

[Footnote continued]

- f. A Rail Service Secondary Market Is A Promising Innovation That The Board Should Consider.

The Board should seriously consider an innovative idea proposed by Enron as a remedy for competitive problems brought about by rail consolidations: the creation of a secondary market in rail services. Under Enron's proposal, the Board would accommodate the development of this secondary market by allowing entities interested in moving goods and materials to secure rail transportation rights from both the carriers themselves and shippers who hold capacity on the railroads. See Enron Comments at 1-2.

- g. Effective Intramodal Competition Requires That The Number Of Railroads Serving Markets Be Increased; This Can Best Be Done Through Divestiture; Competitive Access Is A "Second Best" Solution.

The only sure way to preserve and enhance intramodal competition is to increase the number of independent railroads serving rail dependent markets. IMPACT favors the expansion of intramodal competition to include at least three railroads in as many major markets as possible, as discussed above. Many commenters suggest that the goal of enhanced intramodal competition be

[Footnote continued]

23-24 (Submitting specific regulatory language to prevent the "fundamentally unfair" practice of rail carriers burdening their customers with acquisition premium costs.); Martin Marietta Materials, Inc. Comments at 8-9 (Submitting language to prohibit the passing on to customers of the acquisition premium.); North Dakota Parties Comments at 5 ("To the extent that the carrier paid more than the reasonable value of the property, it should not be able to recoup those costs via higher rates from its captive shippers.").

accomplished by requiring that merged carriers grant other carriers access to their lines to as a means of promoting rail to rail competition. 19/

In the past, the Board has sought to “preserve” competition by imposing narrowly tailored trackage or haulage rights in markets where the merger caused a two-to-one reduction in the number of serving railroads. As IMPACT showed in its opening Comments:

- This remedy did not even purport to enhance competition (see IMPACT’s opening Comments at 13-16), and
- This remedy was inadequate even to preserve competition because narrowly-tailored conditions failed to cover all losses in competition caused by the merger (see IMPACT’s opening Comments at 22-23).

If the Board now seeks ways to enhance competition, as well as to preserve such competition as now exists, it must avoid these two shortcomings of its prior practice. But it should also recognize that the customary antitrust remedy that it has always avoided – divestiture – is the most effect way to preserve and increase the number of railroads serving particular markets.

IMPACT believes that railroads can compete most effectively using their own facilities. Therefore, as explained in IMPACT’s opening Comments (at

19/ See, e.g., PPG Comments at 2 (Promoting mandatory competitive access in all currently captive situations.); Subscribing Coal Shippers Comments at 14-15 (Requesting that the Board impose access relief as a condition to any future merger.); ARC Comments at 4 (Recommending, in addition to or as an alternative to economic regulation, competitive access for captive customers.); Martin Marietta Comments at 6-9 (Proposing language obligating merging carriers to grant reciprocal switching, trackage rights or haulage rights to competing railroads to serve shippers competitively harmed by the transaction.).

23-25), divestiture of some lines of Class I merging carriers to other competing carriers ought to be the favored means for preserving and enhancing competition. 20/

6. The Board Should Consider The Cumulative And Crossover Effects Of Mergers, Both Upstream and Downstream.

IMPACT shares the concern expressed by most commenters that the proposed rules must deal with merger downstream and upstream effects. IMPACT further agrees with the other commenters that the proposed rules lack the specificity that would enable them to accomplish this. 21/

In its opening Comments, IMPACT made a proposal that, among other advantages, would facilitate the Board's evaluation of downstream effects: a 36-month pause between Class I mergers, except for "responsive" merger applications filed as part of the original proceeding. See IMPACT's opening Comments at 18-21. Under this framework, the Board might be able to assess the cumulative effects of the precipitating merger and the resulting responsive mergers in a single transaction. If no responsive rail mergers were filed, the downstream effects of subsequent mergers would be attenuated by the fact that they could not be filed for at least three years.

20/ In its Comments at p. 4, IMC urges the Board to "aggressively use" its divestiture powers to enhance rail competition.

21/ See, e.g., PPG Comments at 3; EEI Comments at 3; NITL Comments at 32.

7. If The Board's Merger Policy Fails To Halt The Class I Railroad's Headlong Rush To Duopoly, A Return To Strict Regulation Will Be Inevitable.

A number of commenters point out that there is already too little effective intramodal competition in the Class I railroad industry, and they propose regulatory reforms to redress that problem beyond the specific context of mergers. 22/ These proposals bring into sharp focus the public policy conundrum that past merger policy has created.

There is no question that the regulatory reforms accomplished by the Staggers Act have benefited both railroads and their customers. But along with the regulatory reforms has come a virtual abandonment of any limits on railroad mergers. The effect of the mergers has been to undermine the basis for the regulatory reforms, that is, reliance on the marketplace and competition. Thus, it is inevitable that customers who face a rail industry that is neither competitive nor effectively regulated will demand protection from their government.

22/ See, e.g., USDOT Comments at 5 (Gateway protection should apply to both merging and non-merging railroads serving gateways affected by a merger.); NITL Comments at 15-18 (Rules designed to insure greater intramodal competition should be applied to both merging and non-merger carriers during rail transactions in order to hold level the playing field for non-merging carriers who otherwise would benefit disproportionately from conditions imposed solely upon merging parties.); EEI Comments at 6-7 (The Board should require all railroads to offer captive shippers "bottleneck" rates and overrule the MidTec doctrine, which requires shippers to show competitive harm before statutory terminal trackage rights can be invoked.); Consumers United for Rail Equity ("CURE") Comments at 2-9 (Urging a revamping of the regulatory structure as a whole to promote competition and increase efficiencies in the rail industry.); ARC Comments at 2, 4 (Board should view any future merger as an opportunity to expand intramodal competition industry-wide. In addition to merger conditions, competitive access can be achieved by implementing effective economic regulations.).

Of course, the rail industry is wrong to claim, as it repeatedly does, that every proposed change in regulation constitutes “re-regulation”. Nevertheless, much that is good would be lost if the railroad industry were subjected to a stricter and more comprehensive regulatory regime. IMPACT is reluctant to advocate any strengthening of regulation, however reasonable, unless it is absolutely essential.

IMPACT hopes that the Board will adopt and apply new merger rules that will prove effective in halting the railroad industry’s pell mell dash towards duopoly (or worse). If the Board fails to do so, additional regulatory protections for rail customers, like the ones proposed by many commenters in this proceeding, will be impossible to avoid. 23/

**B. THE BIG RAILROADS’ OPPOSITION TO MERGER REFORM
THREATENS TO CREATE A CONTINENTAL DUOPOLY AND A
RETURN TO STRICT REGULATION**

1. Summary

The big railroads favor a continuation of the Board’s and ICC’s old policy of approving practically every merger proposal, subject only to narrowly-drawn conditions that purport to preserve a minimal level of intramodal competition. They oppose all significant efforts to reform the Board’s rail merger policy and urge the Board to stand aside while they pursue the final rounds of consolidations that will create a continent-wide duopoly.

23/ Accord Shell Oil Company and Shell Chemical Company Comments at 9, 12 (If the proposed rules effect increased competition, there will be less need for future regulation.).

Although the big railroads condemn any proposal to put limits on their freedom to merge as a return of the pre-Staggers Act era of strict regulation, in fact it is their own policies that would bring about the end of the regulatory reforms effected by the Staggers Act. Market power unconstrained by either competition or regulation is simply intolerable. If the Board allows the big railroads to create a North American railroad industry without effective rail-to-rail competition, a return to strict regulation is inevitable.

2. The Big Railroads' Insistence On A Pro-Merger Policy Is Wrong.

The big railroads object to what they call an “anti-merger” bias in the Board’s Proposed Rules. They argue that all past rail mergers have created public benefits, and that there is no reason to doubt that future Class I mergers will also do so. The big railroads would have the Board give the highest priority to the supposed “efficiency” benefits of mergers, and to give relatively little weight to concerns about intramodal competition. 24/

To the big railroads, effective competition between railroads is – at best – a mixed blessing. As BNSF’s economists put it: Railroads cannot earn enough money where they face effective competition, so they must obtain greater “contributions from those services where competition is not so intense.” See BNSF

24/ See, e.g., American Association of Railroads (“AAR”) Comments at 14; BNSF Comments at 23-32; CP Comments at 8-12; CSX Comments at 25-29, 30-35; NS Comments at 6, 19.

Comments (Gómez-Ibáñez & Kalt Statement, at 7). NS asserts that increasing rail-to-rail competition

can increase rail operating costs and traffic congestion, complicate and impair the quality of rail service provided to customers, undermine the ability of railroads to charge rates that cover their full economic costs . . . , and, ultimately, reduce economic incentives for investment in service-enhancing infrastructure and equipment.

NS Comments at 7. See also, CSX Comments at 35 (“[C]ompetitive enhancements’ . . . could even hinder economically efficient alternatives extant in the marketplace or created by the transaction.”).

It may come as no surprise that the big railroads take such a position, but it is short-sighted and contrary to their own stated interests. Ultimately, only the existence of competition makes it possible to loosen regulatory constraints. The goal of the Staggers Act was thus to replace regulation with competition as much as possible. As stated in the Act, the government’s policy is to “allow, to the maximum extent possible, competition and the demand for services to establish reasonable rates” for rail transportation 49 U.S.C.A. § 10101(1) (West 1997, Supp. 2000). If mergers are allowed to eliminate effective intramodal competition, then even the big railroads’ economists would presumably concede that the scope of regulation would have to expand. See, e.g., BNSF Comments (Gómez-Ibáñez & Kalt Statement, at 6-7 (regulation “provides protections to captive shippers through oversight and capping of rates”)).

Moreover, as for the big railroads’ claim that mergers will benefit the public, the Board has successfully called their bluff. In the Proposed Rules, the

Board proposes to “ensure that [merger] applicants are careful in their presentation of public benefits” by requiring them to “suggest additional measure that [the Board] could take if those benefits are not realized within a reasonable time.” See Notice of Proposed Rulemaking at 14. In chorus the big railroads have objected to any attempt to hold them to their promises of merger benefits. UP claims that this “would impose unrealistic and counterproductive constraints on implementation of future mergers.” See UP Comments at 15. NS argues that “nothing can change the fact that estimates of merger-related public benefits are only estimates” See NS Comments at 37. BNSF’s Krebs chastises the Board for “completely miss[ing] the point of a dynamic marketplace” and questions whether the Board would have “remedies . . . available . . . in such a circumstance.” See BNSF Comments (Krebs Statement at 9).

These shrill protests are totally out of proportion to the Board’s modest proposal to encourage a little more candor from merger applicants in projecting merger benefits. The Board has not threatened to require that merger applicants “guarantee that every projected benefit is realized” (UP Comments at 15), nor to “punish[] railroads that failed to achieve the benefits they projected in their application” (BNSF Comments (Gómez-Ibáñez & Kalt Statement, at 29)). And the Board is right not to do so, because projections of this kind are inherently uncertain.

But given this uncertainty, it is absurd for the railroads to insist that the Board should rely on estimates of public benefits to excuse the certain

anticompetitive effects on future Class I rail mergers. The Board should de-emphasize promises of public benefits in deciding future rail mergers.

In fact, the “end to end” mergers that the big railroads say they want are unlikely to generate the “cost savings and service improvements” (BNSF Comments (Gómez-Ibáñez & Kalt Statement at 23)) that the big railroads promise. The six huge North American railroads are all big enough that they have limited opportunities to enjoy additional economies of scale if they merge with each other (indeed, they may have already grown so big that diseconomies have started to set in). They also have little opportunity to reduce interchange costs:

A transcontinental merger can only eliminate interchanges on the small fraction of rail traffic that moves transcontinentally.

So there is no reason to think that future Class I railroad mergers will do much to improve efficiency or generate any other public benefits. But there is every reason to think that a series of transcontinental rail mergers would have a devastating effect on what is left of intramodal competition in the railroad industry.

3. The Big Railroads’ Objections To The Board’s Minimal Efforts To Promote Competition Are Unfounded.

As discussed above, and in IMPACT’s opening Comments, the Board’s Proposed Rules are insufficient to accomplish their stated objective of restoring competition in the Class I railroad industry. Yet the big railroads condemn even these modest efforts in the most hyperbolic terms.

Contrary to the Class I railroads' assertions, 25/ the Proposed Rules do not empower the Board to "restructure" the railroad industry in accordance with the "Board's preconceived notions of what shape the final North American rail system should take." See BNSF Comments at 56. The Board is not asking to "step in and manage the structure and timing of railroad consolidation." See BNSF Comments (Gómez-Ibáñez & Kalt Statement at 28). Certainly the Board does not propose to "depart from the fundamental deregulatory tenets of the [Staggers] Act" See CN Comments at 7.

But, as even the big railroads themselves must admit, it is likely that "the next round of major rail consolidations will shape the final structure of the industry." See NS Comments at 5. 26/ The Board has not only the power but the duty to oversee that process.

As IMPACT and many other parties discussed in their opening Comments, there is insufficient intramodal competition in the railroad industry today. Under those circumstances, the "business as usual" approach to mergers advocated by the big railroads cannot improve the situation, it can only make it

25/ See, e.g., AAR Comments at 3; BNSF Comments at 16, 44, and 56; KCS Comments at 11.

26/ BNSF observes that the Board's stated objective of fostering "balanced" competition could actually encourage a rush to merge. BNSF Comments at 44. IMPACT agrees that "balance" is not the best word to use for the kind of competition that the Board should foster. The Board should, instead, foster effective intramodal competition.

worse. The Board cannot justly be accused of overstepping its legal authority 27/ in recognizing that reality.

Therefore, in these circumstances, the only way that a major rail merger could be in the public interest would be if it included measures, such as divestiture of lines, that would enhance competition by introducing a second rail carrier into markets that now have but one, or a third rail carrier into markets that now have but two.

Moreover, experience has shown that the approach favored by the big railroads – approving mergers subject to narrowly tailored conditions intended to offset specific, identified, competitive harms 28/ – results in a net reduction in competition, because not all the competitive harms are identified, and the narrowly tailored conditions are never as effective as true intramodal competition. Particularly in the present circumstances, further mergers under the old rules would inevitably lead to a severe loss in what little competition remains in the railroad industry. See IMPACT's opening Comments at 22-23.

A rule providing that merger applicants must propose means for enhancing intramodal competition does not require a railroad to “give away its customers without compensation as a condition of obtaining federal approval to merge.” See BNSF Comments (Krebs Statement at 8). Class I railroads do not own

27/ See, e.g., AAR Comments at 17. On the other hand, CN concedes that “the Board has broader authority than an antitrust court.” See CN Comments at 14.

28/ See, e.g., AAR Comments at 9; NS Comments at 22-23; BNSF Comments at 10.

their customers and have no vested right to hold them captive and exploit them for higher “contributions”.

The big railroads are also wrong in claiming that enhancement of competition involves an allocation of favors and benefits to customers without any principled basis for choosing who benefits and who does not. ^{29/} The principles that the Board should follow are that competition should be enhanced (i) in rail dependent markets, (ii) that are served by fewer than three independent rail carriers, (iii) by increasing the number of serving rail carriers from one to two or from two to three, to the extent possible. See IMPACT’s opening Comments at 13-14. There are numerous methods that might be used to enhance competition, as discussed in Part A of these Reply Comments, but the most effective method will typically be divestiture. ^{30/} See IMPACT’s opening Comments at 23-25.

Furthermore, the initiative for such enhancements should come from the applicant carriers, not from the Board. As discussed in IMPACT’s opening Comments, the Board should not devise its own conditions in order to approve a merger that is too anticompetitive as presented by the applicants; the Board should simply deny such a merger. See IMPACT opening Comments at 21-22. The applicants should have an incentive to propose effective measures to preserve and

^{29/} See NS Comments at 8, 30-32; BNSF Comments at 42.

^{30/} As the big railroads themselves acknowledge, using trackage rights to solve competitive problems can lead to operating conflicts and disputes between the landlord and tenant railroads. See BNSF Comments (Gómez-Ibáñez & Kalt Statement at 20).

enhance competition, rather than run the risk that the Board will deny the proposed merger. 31/

4. The Board Is Correct That Downstream Effects Of Mergers Should Be Considered.

In an industry that is as highly concentrated as the Class I railroad industry, it is inevitable that one merger will set off another. This is not speculation; it is history. The merger of the Burlington Northern and the Atchison Topeka & Santa Fe made it inevitable that Union Pacific would take action, rather than accept second place in the west; and as most observers expected, UP's response was to take over Southern Pacific. Those mergers left only two giant carriers in the U.S. west, while there were three large carriers in the U.S. east. This was an unstable situation, because it meant that if the western carriers precipitated transcontinental mergers, one of the three eastern carriers could be left out in the cold. Neither Norfolk Southern nor CSX wanted to run the risk of being the one. The result was the bidding war for Conrail, ending in a two-railroad east facing a two-railroad west.

It was a surprise when BNSF and CN proposed to merge, because most observers were focusing on the U.S. railroads and a direct east-west match-up, and everyone recognized that the U.S. railroads were still suffering from the hangovers from their previous merger binges, and were not yet ready for their next mergers.

31/ Of course, other parties should also be permitted to propose, and the Board should consider, additional conditions, or improvements to conditions proposed by the applicants.

The anguished reaction of the other big railroads to the BNSF-CN proposal was due to the fact that they weren't then in a position to start their responsive mergers. From the comments filed by the big railroads in this docket, the Board can be sure that the next several mergers are teed up and ready to go when the moratorium expires.

The big railroads use a strawman argument to oppose the Board's proposal to include downstream effects in its merger analysis. They pretend that the Board is demanding that they "predict[] downstream or crossover effects with precision", and then they argue that no such precision is possible. ^{32/} But no great precision is required to give reasonable consideration to downstream effects, and it does not take a seer to make a useful projection of likely tactical responses to a particular merger proposal. After all, there are now two giant railroad systems in the U.S. east, two in the U.S. west, and two in Canada (each with a significant presence in the north central U.S.). If two of the six players propose a merger, there is only a finite number of possible responsive combinations.

The big railroads also claim that it would be impossible to incorporate an analysis of downstream effects into a reasonable decision on a merger application. ^{33/} Thus, one of BNSF's consultants argues that a railroad opposed to

^{32/} See AAR Comments at 23. But see NS Comments at 51-52 ("NS does not understand the Board's proposed rule to require this level of detail and precision in applicants' assessment of downstream effects.").

^{33/} CN says that the Board "would then impose its own industrial policy", "picking winners and losers in the abstract". See CN Comments at 18.

a proposed merger “would need only to allege that it would respond to the proposed merger by proposing a patently outrageous merger in order to block approval of the proposed merger.” See BNSF Comments (Pierce Statement at 21). This is backwards. There would be no problem in dealing with the threat of an “outrageous” responsive merger: the Board could just turn it down. The problem is that approval of one merger may make the next merger the lesser of two evils – as happened when the UP-SP merger was proposed right after the BN-SF merger was approved – and thereby limit the Board’s options.

Considering downstream effects is simply common sense in the current highly concentrated state of the Class I railroad industry. It would be as foolish for the Board to ignore possible responsive mergers as it would be for a driver on a busy highway to ignore the car in the next lane.

In contrast to the other big railroads, UP faces the reality that the next round of mergers will take the railroad industry down the path to duopoly.

Any combination among the six largest remaining railroads in North America would be part of and would drive what many parties at the Board’s public hearing described as the “end game” in rail consolidations. Before approving any additional Class I merger the Board should consider whether the “end game” is in the public interest. This is the overriding public policy question before the Board.

See UP Comments at 25 (Appendix A, UP May 16, 2000 Comments, at 4). UP offers two suggestions for dealing with this overriding question: First, that future Class I merger applicants “address . . . whether a two-railroad North American rail system would be in the public interest”; and second, that “the Board should announce now

that it may consider such proposals [for a series of mergers leading to duopoly] in a single, combined proceeding.” Id. at 26 (Appendix A at 5).

For the reasons stated in IMPACT’s opening Comments (pp. 5-10, and the analyses of William Tye and Michael Nelson discussed there), we think it evident that “a two-railroad North American rail system” would not be “in the public interest”, so the question on which the Board should focus in the next merger case is whether that merger would push the industry in that direction. However, if the Board wanted to consider further whether a duopoly would be desirable, UP’s proposal to require merger applicants to address the issue would provide an opportunity for the Board to do so.

IMPACT also agrees with UP that it would make sense to consider the entire series of end game mergers “in a single, combined proceeding.” However, the UP proposal is flawed because it would only work if all the end game mergers were filed at the same time, and there is no assurance that this would happen. In contrast, IMPACT’s proposal for a “cooling off” period between Class I mergers would encourage railroads to file their “responsive” merger applications in the proceedings on an initial merger. Under IMPACT’s proposed rule, once Merger A is filed, the proponents of responsive Merger B would be encouraged to file in the same proceeding, to avoid the cooling off period. See IMPACT’s opening Comments at 19-21. If the “cooling off” period proposal is adopted by the Board, it is quite possible that most or all of the “endgame” for Class I rail mergers would be played out in a single proceeding.

5. The Big Railroads' Objections To Post-Merger Oversight Are Exaggerated, But Oversight Should Not Be Relied On To Prevent Anticompetitive Mergers From Injuring The Public.

The big railroads make quite a show of their fear that the Board's proposal to include in its merger rules express provision for post-merger oversight proceedings could lead to retroactive imposition of conditions in the event that a merger does not meet all of its proponents rosy predictions. ^{34/} In fact, as discussed in Part A of these Reply Comments, oversight proceedings never have been used to impose any significant new conditions on a merger after it was consummated, and there is nothing in the Board's Proposed Rules that suggests that future oversight will be any more effective than past oversight has been.

6. The Service Assurance Plans That The Big Railroads Say They Support Are Insufficient To Protect Railroad Customers.

Given recent history, the Class I railroads could hardly oppose the Board's modest proposals regarding service assurance plans, but what they support is not an effective assurance of good service, but only more promises of good service. ^{35/}

As IMPACT and many other parties have shown, what customers need and deserve are enforceable assurances that future mergers will not cause severe

^{34/} See BNSF Comments at 6; See NS Comments at 50; See UP Comments at 5-6.

^{35/} See AAR Comments at 12, 20-22; NS Comments at 10; KCS Comments at 20-21; BNSF Comments at 5.

degradation of service as so many past mergers have done. ^{36/} It is all well and good for the Board to insist that merger applicants provide implementation plans that show that they have thought through the problems of putting the two (or more) railroads together successfully, and contingency plans that show that they have thought through what to do when their implementation plans fail. But customers need more than that. Customers need assurance not only that service will be maintained, but also that they will be quickly and adequately compensated for their losses caused by merging railroads' inability to perform their legal obligations. Merger applicants should be required to show that they have negotiated satisfactory agreements with their customers to provide this assurance. See the discussion in Part A of these Reply Comments.

The Class I railroads generally object that requiring such agreements would give customers too much leverage, and that there is such inherent uncertainty in merger planning that it would be wrong to penalize railroads for their failures. ^{37/} An exception is BNSF, which supports the idea that merging

^{36/} It is not the case, as the big railroads claim, that "only" the UP-SP and NS-CRC and CSX-CRC mergers resulted in service problems. There were also serious service problems associated with the BN-SF and UP-CNW mergers, which seem modest only because they were not as devastating as those caused by UP-SP and the Conrail mergers. Customers must now assume that a merger without serious service problems will be the exception, not the rule.

^{37/} See AAR Comments at 20-22; NS Comments at 10; KCS Comments at 20-21; UP Comments at 10.

railroads should negotiate meaningful service guarantees with their customers. See BNSF Comments at 35.

On this point BNSF is right. The Board certainly can and should demand that applicants submit detailed merger plans, and the Board can and should review those plans. But the Board, with the limited size of its staff, cannot possibly expect to detect the subtle flaws in the merger implementation plans that will create the next “meltdown”. Neither can the Board determine in advance whether the applicants’ contingency plans are adequate and workable for all contingencies. The real parties with real interests at stake are the railroads’ customers, and the Board should make clear that a proposed merger is unlikely to be approved if the customers say the service assurances are inadequate. That is not giving shippers too much leverage, it is simply giving them their due.

7. The Board Should Adopt A Procedural Schedule That Allows Adequate Investigation And Evaluation Of Proposed Mergers.

BNSF argues that the Board should establish a procedural schedule for Class I rail mergers that would require that proceedings be completed in less than a year. See BNSF Comments at 5-6, 8, 17-23. To accomplish this, BNSF suggests that such fripperies as interrogatories and depositions could be eliminated. See BNSF Comments (Krebs Statement at 5).

IMPACT believes that rail merger proceedings should be as expedited as possible and as prolonged as necessary in order for the parties and the Board to explore the issues thoroughly. At present, a one-year schedule seems totally unrealistic. Any merger among two or more of the six big Class I railroads is bound

to have wide-ranging ramifications; such a merger cannot be examined adequately within the time frame BNSF advocates. This is particularly true because today the principal burden of challenging a merger application lies with customers and their associations, rather than with competing railroads as used to be the case; it takes customers longer to reach a decision to participate and then prepare to do so than it used to take railroads to do so. Moreover, customers are unlikely to have the in-house expertise on rail issues that railroads have, so they must rely more on discovery and on independent experts to prepare their case. 38/

The idea that effective discovery procedures should be abandoned in order to expedite merger proceedings is particularly offensive. Without discovery, parties opposing a merger would be unable to look behind the self-serving presentations of the merger applicants. The Board's experience surely teaches that effective use of discovery tools by merger opponents can amplify the truth about a merger considerably. A dramatic example occurred in the SF-SP merger, where KCS discovered a confidential Santa Fe document, which revealed that one of the motives behind the merger was Santa Fe's desire to obtain monopoly power. See Santa Fe Southern Pacific Corp. – Control – Southern Pacific Transportation Co., 2 I.C.C. 2d 709, 804-07 (1986). Although the results of discovery are often more mundane than this, the importance of discovery cannot be gainsaid.

38/ See IMPACT's May 16, 2000 Comments (Statement of Michael A. Nelson) at 56-57.

Therefore, IMPACT opposes imposition of a draconian procedural schedule for Class I rail mergers.

8. There Should Be No Special Exception From The Merger Rules For KCS At This Time.

KCS, the smallest independent Class I railroad, asks that it be excluded from the full scope of the Board's new Class I merger rules, in light of the fact that it is so much smaller than the other Class I railroads. See KCS Comments at 5-7. There is merit in this proposal, but it is too soon to grant KCS the special treatment it requests. Given the extremely high degree of concentration in the Class I railroad industry, it is entirely possible that the acquisition of KCS by one of the larger Class I railroads could have a crucial effect on the overall structure of the railroad industry. If the Board adopts pro-competition merger rules, and as a result intramodal competition among Class I railroads is increased, then it may be possible to grant KCS the special treatment it requests.

CONCLUSION

The Staggers Act's regulatory reforms depend on "effective competition among rail carriers". ^{39/} These proceedings give the Board a last chance to preserve the benefits of those reforms by turning the Class I railroad industry away from its fatal compulsion to merge its way to duopoly. By adopting the improvements to its Proposed Rules that IMPACT and others have suggested in their comments, the

^{39/} SF-SP, 2 I.C.C. 2d at 722.

Respectfully submitted,



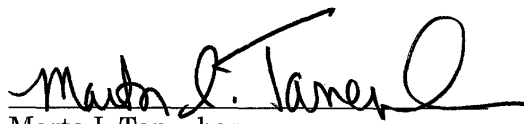
George W. Mayo, Jr.
Eric Von Salzen
Marta I. Tanenhaus
HOGAN & HARTSON L.L.P.
555 Thirteenth Street, N.W.
Washington, D.C. 20004-1109
(202) 637-5600

Attorneys for the Committee To Improve
American Coal Transportation

December 18, 2000

CERTIFICATE OF SERVICE

I hereby certify that on December 18, 2000 I caused to be served, by first-class mail prepaid, a true and correct copy of the foregoing Reply Comments of the Committee To Improve American Coal Transportation on all Parties of Record in STB Ex Parte No. 582 (Sub-No. 1).


Marta I. Tanenhaus

Dated: December 18, 2000